OPENING STATEMENT OF
RANKING DEMOCRATIC MEMBER PAUL E. KANJORSKI

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

HEARING ON H.R. 3574, THE STOCK OPTION ACCOUNTING REFORM ACT

WEDNESDAY, MARCH 3, 2004

Mr. Chairman, we meet for the second time in the 108th Congress to study the accounting treatment of stock options. Specifically, we will today examine H.R. 3574, a bill that would unnecessarily interfere with the independence of the Financial Accounting Standards Board.

Without question, stock options have played an important and crucial role in the ongoing success of many American businesses and the creation of wealth for many American households. The accounting treatment of stock options, however, has also caused significant controversy for more than two decades. The decisions of the Financial Accounting Standards Board to revisit this matter last year and issue a draft rule later this month have therefore rekindled a fiery debate.

In the wake of the recent tidal wave of accounting scandals, support for mandatory expensing has increased significantly. A recent survey by Merrill Lynch found that more than 90 percent of institutional investors want stock options expensed. The four largest accounting firms have also now called for the expensing of stock options. Moreover, many respected financial experts have effectively made the case for options expensing, including William Donaldson, William McDonough, Warren Buffett, Alan Greenspan, Paul Volcker, and Joseph Stiglitz.

In addition, nearly 500 companies have adopted or are in the process of adopting fair value expensing of stock options. Respected corporations like Home Depot, General Motors, General Electric, Wal-Mart, Microsoft, and Amazon have all decided to treat stock options as expenses. Several companies headquartered in Pennsylvania have also done the same, including Mellon Financial, Hershey Foods, and First Keystone Corporation in Berwick.

As we proceed today and in the future, I must caution my colleagues about the ongoing need to protect the independence of the Financial Accounting Standards Board. A decade ago, the Congress unfortunately strong-armed this private regulatory body into abandoning its efforts to adopt a rule requiring stock options expensing. We now know that this retreat contributed to the financial storm on Wall Street in 2001 and 2002.

To protect against similar incidents in the future and safeguard the public interest, we incorporated into the Sarbanes-Oxley Act a provision granting an independent funding stream to the Financial Accounting Standards Board. The active consideration of the Stock Option Accounting Reform Act by our panel, in my view, would threaten this recently approved enhanced independence, intervening in the board's ability to make unbiased decisions and disrupting an objective process for reasons other than sound financial reporting.

Other leaders on Capitol Hill have agreed with me about the wisdom of protecting the independence of the Financial Accounting Standards Board. Earlier this year, Senator Shelby and Senator Sarbanes, the two most powerful members of the Senate Banking Committee, asserted their bipartisan opposition to intervening in the activities of the board. Chairman Oxley has also previously said that compromising the independence of the private board that sets the accounting rules “could negatively impact efforts to improve the transparency of financial reports.” I wholeheartedly agree. Deciding what should be accounted for and how it should be accounted is the job of the Financial Accounting Standards Board, not the Congress.

Although the board has not yet released its draft rule on the expensing of stock options, I am pleased that the agency is working to address this important issue. Employee stock options are a type of compensation, just like a salary or a bonus. Because compensation is an expense and because expenses influence earnings, employee stock options should be counted against earnings and subtracted from income.

Mandatory stock options expensing will further help investors to make better decisions. Individuals, for example, might have previously made different choices about the stock of AOL Time Warner. In 2001, the failure to account for employee stock options on the company’s balance sheets resulted in a profit of $700 million instead of an operating loss of $1.7 billion. Unlike the current system where some businesses expense options and others do not, a mandatory expensing rule would also facilitate comparisons between companies, helping investors to make apples-to-apples evaluations rather than apples-to-oranges assessments.

In closing, Mr. Chairman, our capital markets can remain the strongest in the world only when the rules are clear and credible, corporate activity is transparent, and the data is unbiased and comparable. Stock options are expenses. To strengthen investor confidence and promote the international convergence of corporate reporting standards, the Financial Accounting Standards Board must therefore proceed with diligence, and without political interference, in these matters.